

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

PRICE ELASTICITIES AND INTERNET DIVERSION

Docket No. RM2014-5

**COMMENTS OF THE NATIONAL POSTAL POLICY COUNCIL
ON TECHNICAL CONFERENCE AND ATTACHMENT A**

(September 19, 2014)

The National Postal Policy Council ("NPPC") respectfully submits these comments on the paper presented at the August 13 Technical Conference in this proceeding and related matters.

In response to a petition filed by NPPC and seven other parties, the Commission initiated this proceeding to review and consider improvements to the elasticities demand model used by the Postal Service and the Commission.¹ The Commission stated: "As a preliminary step, the Commission intends to explore possible improvements to the current method of deriving demand elasticities by product." *Id.* To that end, the Commission scheduled a technical conference at which a paper co-authored by Lyudmila Bzhilyanskaya, Margaret Cigno, and Edward Pearsall (attached as Attachment A to Order No. 2117) was presented and invited interested parties to participate in that conference and submit comments. *Id.* at 5.

¹ Notice and Order Scheduling Technical Conference, Order No. 2117 at 4 (July 9, 2014).

NPPC commends the Commission for initiating this proceeding. Considering alternatives and improvements to the current understandings of the price elasticity of demand for postal products and the effects of electronic alternatives on that demand in this proceeding will allow a more thoughtful review than would be possible in a rate proceeding or compliance review. NPPC welcomes this notice and the technical conference as the first step towards improvements in this area.

NPPC participated in the August 13 Technical Conference and offers these comments on it and the Attachment A paper. In general, the Attachment A paper consists of two parts: a “Trunk” model that estimates overall demand for postal products, and a “Branch” model that estimates the shares of various products along each branch, from which estimated price elasticities are derived. NPPC believes this model offers potential for improvement over the current model insofar as it demonstrates an ability to estimate price elasticities at the product and shape level, and encourages continued work along this line of inquiry.

However, on a broader level, the Trunk model essentially follows the approach taken by the Postal Service’s prevailing demand model. As NPPC has said previously, the prevailing model may no longer provide the Postal Service and Commission with accurate information regarding price elasticities and electronic diversion.

First, the authors of the Attachment A paper agree with NPPC² that real postal prices barely changed between 2006 and 2014, a period of unprecedented structural change in demand driven by tremendous changes in broadband and wireless technologies used in communications. The lack of substantial real change in postal prices during a period dominated by the introduction of the iPhone, tablet computers, fiber optics, and widely available wireless broadband services, as well as new “social media” content services, means that the effect of price on volume in recent years cannot be determined from the data, because there essentially have been no real price changes.

Second, neither the Postal Service model nor the Attachment A paper has yet found economic variables that explain the substantial portion of mail volume lost to electronic diversion in recent years. In what NPPC thinks is not a coincidence, neither models electronic diversion directly. Instead, both models address electronic diversion by relying upon trend factors and intervention variables to make their equations fit. These are artificial mathematical adjustments that have no genuine economic meaning. Thus, they are inherently incapable of causally explaining electronic diversion. NPPC suggests that developing a solid way to model the effects of electronic diversion directly may be one of the most fruitful areas for further research.

For these reasons, neither version of the prevailing model may necessarily be capable of assessing price effects on mail volume or the effects of electronic diversion in today’s postal and technological environment. The Branch model in

² See Statement of Lawrence G. Buc of SLS Consulting, Inc. (“*Buc Declaration*”) at 8-10.

the Attachment A paper usefully advances the issue by addressing the need to examine price elasticities at the product level, but an effort to reassess the Trunk model would be well worthwhile.

As for the Branch model itself, which distributes a certain postal “spend” among postal products, NPPC, as noted above, is encouraged by the possibility of estimating price elasticities at the product and shape level. However, as an organization of mailers, NPPC has doubts about some the assumptions underlying the Branch model about how mailers make their mailing decisions. In addition, some factors that affect mailing choices are not reflected in that model.

For example, in the current Attachment A Branch model, the choice of shape is the last decision point facing a mailer. See Attachment A at 3. In fact, NPPC submits that this often is the first decision a mailer makes. During the technical conference, Mr. Pearsall seemed to acknowledge this when he mentioned the possibility that future work may treat shape as a more important consideration.³

From discussions with its members, NPPC also is skeptical that mailers actually divide their expenditures by class “without knowing how First-Class expenditures will be sub-divided by category.” Attachment A at 3. NPPC members, at least, are quite aware of the postage prices that they will be charged at every stage of the decision-making process, and take them into account even when deciding upon which class of mail to use.

³ It merits mention that when First-Class Presort flats rates rose 11..5 percent in 2008, while the corresponding Letter rates rose 5.12 percent, there was an immediate dramatic decrease in flats volumes.

More generally, it would be useful to study further how mailers decide between classes of mail, including how a mailer planning a promotional campaign chooses between, say, First Class and Standard Regular mail. Many factors affect that decision other than postal price, including desired response rate, cost of production, timeliness of delivery, and others. It is unclear how the Branch model takes these considerations into account.

It also deserves mention that in some instances legal requirements dictate that particular mailings – such as some financial account statements and insurance cards and notices – must be delivered by First Class mail. In these cases, the choice of postal product (if the item is to be mailed) is determined by law, and is not a matter of mailer discretion. Only a decision by the recipient to accept electronic delivery would change the mailing decision, and that change would be to leave the mail altogether. Such laws may provide additional incentive for electronic diversion; it is also worth considering whether or how these legal requirements may affect either the Trunk or the Branch model.⁴

Finally, an accurate model should attempt to reflect the decisions mailers face when planning and executing a mailing. The validity of the assumptions used in the Attachment A paper, and in any other research, can best be tested by studying how mailers make mailing decisions in the real world.

⁴ Some states have amended their laws to allow electronic communication of at least some statements and notices. And many members of the regulated industries are trying to liberalize the laws in other states. This area will continue to evolve. To the extent that electronic delivery becomes more generally available, the price of First-Class Mail will play a more important role in decisions regarding how to deliver such required messages.

To do so, as stated in the petition initiating this proceeding, the Commission should initiate and conduct a sound quantitative and qualitative analysis of mailer behavior, including how they make mailing decisions. This effort should produce a modeling of mailer behavior, based on interviews and surveys. The petition submitted by NPPC and other mailers that gave rise to this proceeding outlined the basic steps such an effort could take.⁵

Ideally, the estimates of price elasticity of demand derived from econometric modeling and from surveying mailers would converge. To the extent that new economic models produce similar results to those derived from studying mailer decision-making, mailers, the Commission, the Postal Service, and other interested parties could have more confidence in the accuracy of price elasticities and the estimates of Internet diversion used in postal proceedings.

For these reasons, the National Postal Policy Council applauds the Commission for initiating this proceeding. NPPC urges the Commission to continue this process by encouraging further research on econometric modelling,

⁵ Postal economist Lawrence Buc made an initial effort to do so in 2013. His survey and results were submitted into the record of Docket No. R2013-11. See Comments of the National Postal Policy Council, the Major Mailers Association, and the National Association of Presort Mailers in Connection with the Attached Statement of Lawrence G. Buc (Nov. 26, 2013).

but also to develop an improved understanding of how mailers make decisions
by surveying a representative sample of mailers.

Respectfully submitted,

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